

**LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS**

301 State House
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FISCAL IMPACT STATEMENT

LS 7281

BILL NUMBER: HB 1766

DATE PREPARED: Jan 10, 2001

BILL AMENDED:

SUBJECT: TRF Benefit Computations and Service Credit.

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FUNDS AFFECTED: X GENERAL
DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: This bill:

- 1) provides that retirement benefits for members of the Indiana State Teachers' Retirement Fund (TRF) are based on the three years of service (rather than five years of service) in which compensation was highest;
- 2) increases the multiplier used to determine retirement benefits for TRF members from 1.1% to 1.4%; and
- 3) provides that active members of TRF who serve on active duty in the armed services of the United States for at least six months are entitled to purchase service credit for the time served on active duty, to the extent service credit is not granted for that time under existing TRF provisions concerning military service credit. It requires a member to have at least ten years of creditable service in TRF before the member may use the purchased military service credit for purposes of computing retirement benefits. The bill specifies that these benefit changes apply only to members of TRF who retire after June 30, 2001.

Effective Date: July 1, 2001.

Explanation of State Expenditures: The fiscal impact of the provisions of this proposal are included in the following tables.

1) Retirement benefits for members of TRF based on the three years of service (rather than five years of service) in which compensation was highest:

<u>Three Year Final Average Salary (FAS)</u>	<u>Closed Plan</u>	<u>Post '96 Plan</u>	<u>Total</u>
Increase in Unfunded Actuarial Accrued Liability (UAAL)	\$376 M	\$23 M	\$399 M
Increase in Employer Contributions Rate as % of Payroll			
Normal Cost	0.5%	0.5%	0.5%
UAAL (40 year amortization)	<u>0.5%</u>	<u>0.2%</u>	<u>0.4%</u>
Total	1.0%	0.7%	0.9%
Increase in Payout First Year	\$1.5 M	\$20,247	\$1.5 M
Increase in Payout Second Year	\$3.1 M	\$46,664	\$3.1 M
Increase in First-Year Contribution	na	\$3.8 M	\$3.8 M

2) Increase of the multiplier used to determine retirement benefits from 1.1% to 1.4%.

<u>1.4% Multiplier</u>	<u>Closed Plan</u>	<u>Post '96 Plan</u>	<u>Total</u>
Increase in Unfunded Actuarial Accrued Liability (UAAL)	\$1,613 M	\$99.6 M	\$1,712.6 M
Increase in Employer Contributions Rate as % of Payroll			
Normal Cost	2.0%	2.1%	2.0%
UAAL (40 year amortization)	<u>2.1%</u>	<u>0.7%</u>	<u>1.8%</u>
Total	4.1%	2.8%	3.8%
Increase in payout first year	\$6.6 M	\$84,880	\$6.6 M
Increase in payout second year	\$13.4 M	\$195,627	\$13.6 M
Increase in first-Year Contribution	na	\$15.1 M	\$15.1 M

<u>Combined Impact of 1 and 2, above.</u>	<u>Closed Plan</u>	<u>Post '96 Plan</u>	<u>Total</u>
Increase in Unfunded Actuarial Accrued Liability (UAAL)	\$2,091.4 M	\$129.7 M	\$2,221.1 M
Increase in Employer Contributions Rate as % of Payroll			
Normal Cost	2.6%	2.7%	2.6%
UAAL (40 year amortization)	<u>2.7%</u>	<u>0.9%</u>	<u>2.4%</u>
Total	5.3%	3.6%	5.0%
Increase in Payout First Year	\$8.6 M	\$110,429	\$8.7 M
Increase in Payout Second Year	\$17.3 M	\$254,624	\$17.6 M
Increase in First-Year Contribution	na	\$19.4 M	\$19.4 M

The estimates, above, are based on the same data, methods, and assumptions as were used for the most recent annual actuarial valuation, as of June 30, 1999.

3) The bill also provides that active members of TRF who serve on active duty in the armed services of the United States for at least six months are entitled to purchase service credit for the time served on active duty, to the extent service credit is not granted for that time under existing TRF provisions concerning military service credit. It requires a member to have at least ten years of creditable service in TRF before the member may use the purchased military service credit for purposes of computing retirement benefits. The bill specifies that these benefit changes apply only to members of TRF who retire after June 30, 2001.

This section can result in increased future payouts for TRF in certain situations, as described below.

Background: The bill provides that the purchase of the military service credits by members of TRF must be equal to the product of the following: 1) the member's salary at the time the member actually makes a contribution for the service credit; and 2) a rate determined by the actuary of the fund based on the age of the member at the time the member actually makes a contribution for service credit and computed to result in a contribution amount that approximates the actuarial present value of the benefit attributable to the service credit purchased. However, a couple of circumstances under which a member of TRF may wish to purchase military service credit and the potential impact to the funds are identified below.

A) If a member wanted to purchase military service credit (or any service credit), the actuary for the fund calculates the cost of that service based on the member's current salary, current TRF service earned, and the member's current age. This cost represents the full actuarial cost of the service at the time of the purchase (excepting any future Cost of Living Adjustments (COLAs) that may be awarded). In other words, if a member purchases the service credit on one day and then retires with benefits commencing the next day, there would be no immediate fiscal impact to TRF. There also would be no immediate real gain to the member because the additional benefits received due to military service would be actuarially equivalent to the purchase price of the military service. This changes, however, once a COLA has been awarded. Since COLAs were not included in the purchase price, such a COLA would represent a real gain to the member and a fiscal impact to TRF.

B) If the member purchases military service credit and continues employment, the member may also be able to benefit from the earlier purchase of service credit for a second reason. As the member continues employment, the member can expect increases in salary. These salary increases will increase the benefit the member can expect to receive at retirement. However, the purchase price of the military service was based on the member's salary **at the time of purchase** before any increases in salary. Any increase in the value of the member's benefit because of salary increases was not included in the purchase price, therefore representing a real gain to the member and an impact to the fund.

Explanation of State Revenues:

Explanation of Local Expenditures: See tables above.

Explanation of Local Revenues:

State Agencies Affected: Teachers' Retirement Fund.

Local Agencies Affected: School Corporations.

Information Sources: Denise Jones of Gabriel Roeder Smith & Co., actuaries for the Teachers' Retirement Fund, 1-800-521-0498.

DEFINITIONS

Unfunded Actuarial Liability (sometimes called the unfunded liability) of a retirement system at any time is the excess of its actuarial liability at that time over the value of its cash and investments.

Normal Cost--The normal cost is the current value of benefits likely to be paid on account of members' service being rendered in the current year.